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The Status of ERISA Plan Benefits in Bankruptcy After Patterson v. Shumate

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Abstract

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KEYWORDS: facts, restriction, bankruptcy

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I. INTRODUCTION

The United States Supreme Court recently handed down a decision that puts to rest a conflict among courts around the country.[1] In *Patterson v. Shumate*,[2] the Court declared that Employment Retirement Income Security Act of 1974 (ERISA)-qualified pension plan benefits[3] are excludible from

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1. *See infra* notes 19, 21 and accompanying text.

2. 112 S. Ct. 2242 (1992).

3. ERISA, federal law regulating private pension and welfare plans, is comprised of labor and tax provisions. Labor provisions, which spell out plan requirements, namely anti-alienation, vesting, funding and participation standards for pension plans, are contained in Title 29 of the United States Code, §§ 1001-1461 (within these sections are also important reporting and disclosure components). Tax provisions, which afford ERISA plans meeting the requirements above favorable tax treatment, are found throughout Title 26 of the United States Code. *See* I.R.C., §§ 401-57. The Act, ERISA, is independently codified as well.

ERISA's main goal, as expressed by Congress, is to assure American workers that they can rely on a source of income promised to them by their employers via pension benefits

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a bankruptcy estate (estate) pursuant to section 541(c)(2) of the Bankruptcy Code (Code).[4] Although the *Patterson* decision obviated the need for the Court to consider the alternative argument that ERISA-qualified pension interests are exempt from the debtor's estate,[5] the exemption analysis is still viable and necessary as it pertains to other plan interests governed by

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upon retirement. *See* 29 U.S.C. § 1001(a) (1988). Essentially, ERISA's goal is realized when employers provide their employees with pension plans that, if administered and organized in accord with the aforementioned plan requirements, are also deemed "qualified" (hence the phrase "ERISA-qualified pension plan"), allowing for employers to reap special federal income tax breaks, which is really the incentive behind employers initiating these plans. Qualified ERISA pension plan tax advantages basically entail that: The employer's contribution to the plan will be tax deductible; the participating employee is not assessed a tax on his interest in the plan until he receives his plan benefits; earnings on plan assets accrue without federal and state income tax assessments until such earnings are distributed to the beneficiary; and distributions to plan beneficiaries enjoy various other tax advantages. *See generally* Richard D. Brown, *Pension and Profit Sharing Plans Distinguished*, 327 PLI/Tax 89, PLI Order No. J4-3659 (1992).

ERISA defines pension plans in 29 U.S.C. §1002(2)(A)(i) & (ii):

> (2)(A) Except as provided in subparagraph (B), the terms "employee pension benefit plan" and "pension plan" mean any plan, fund, or program which was heretofore or hereafter established or maintained by an employer or by an employee organization, or by both, to the extent that by its express terms or as a result of surrounding circumstances such plan, fund, or program—
> (i) provides retirement income to employees, or
> (ii) results in a deferral of income by employees for periods extending to the termination of covered employment or beyond, regardless of the method of calculating the contributions made to the plan, the method of calculating the benefits under the plan or method of distributing benefits from the plan.

29 U.S.C. § 1002(2)(A)(i), (ii) (1988).

4. *Patterson*, 112 S. Ct. at 2246-47.

5. *Id.* at 2249. Since the initial analysis entails whether the debtor's property interest is includible as property of his bankruptcy estate to which creditors share, and the Court found that Shumate's interest was excluded and, thus, not accessible to his creditors, it did not have to proceed to the next step in the analysis, namely, whether property of the estate could still be either partially or totally exempted from a creditor's reach.

An exemption is a "right given by law to allow a debtor to retain a portion [or all] of his personal property free from seizure and sale by [his] creditors under judicial process." *See In re* Komet, 104 B.R. 799, 806 (Bankr. W.D. Tex. 1989) (citing Clark v. Nirenbaum, 8 F.2d 451, 452 (5th Cir. 1925), *cert. denied*, 270 U.S. 649 (1926)).

Exemptions by the debtor are authorized as part of an important policy underlying the Code, namely, to give an individual debtor emerging from bankruptcy a "fresh start," thereby allowing him to hold onto various essential items, such as his homestead, some furniture and other necessities. H.R. REP. NO. 595, 95th Cong., 1st Sess. 126 (1977); *In re* Hahn, 5 B.R. 242, 244 (Bankr. S.D. Iowa 1980).

ERISA.[6]

This article will primarily review the *Patterson* Court's analysis regarding the exclusion of ERISA-qualified pension plans as property of the estate and will, secondarily, explore the exemption issues surrounding other ERISA plan interests that cannot be similarly excluded as estate property.

II. *Patterson v. Shumate*

A. *Background*

It is fundamental in bankruptcy law that at the moment of filing for relief under any chapter of the Code, an estate is created for the benefit of the debtor's creditors, comprised of all the debtor's legal and equitable interests in property.[7] Property contained within the bankruptcy estate is intended to encompass a broad range of interests, including tangible and intangible property, interests owned by the debtor to which a third person has possession and even causes of action held by the debtor.[8]

Yet despite the breadth of section 541(a)(1), the Code contains various narrow provisions that exclude specific property interests from the debtor's bankruptcy estate.[9] The pertinent exclusion, addressed by the Court in *Patterson,* is section 541(c)(2) which states: "A restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under nonbankruptcy law is enforceable in a case under this title."[10] The Court had to primarily determine what type of law constituted "applicable non-bankruptcy law," so that it could, thereafter, evaluate whether the debtor's pension benefit interests contained an enforceable restriction on transfer under such applicable nonbankruptcy law, so as to entitle the debtor to exclude his pension interests from his bankruptcy estate.[11]

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6. *See infra* part III.

7. 11 U.S.C. § 541(a)(1). This provision states in pertinent part: "The commencement of a case . . . creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held . . . all legal or equitable interests of the debtor in property as of the commencement of the case." *Id.*

8. *See id.* § 541(a)(1)-(7); *see also* H.R. REP. NO. 595 95th Cong., 1st Sess. 367-38 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5787, 6323-24; United States v. Whiting Pools, Inc., 462 U.S. 198, 204-05 (1983).

9. *See* 11 U.S.C. § 541(b)(1)-(3), (c)(2), (d) (1988).

10. *Id.* § 541(c)(2); *Patterson*, 112 S. Ct. at 2246.

11. *Patterson*, 112 S. Ct. at 2246-47.

B. *Facts and Procedural History*

In 1982, Coleman Furniture Corporation (Coleman) filed for relief under chapter 11 of the Code, in the State of Virginia.[12] Subsequently, the case was converted to a chapter 7 proceeding and Roy Creasy was appointed as the trustee, to collect, liquidate and distribute all property comprising Coleman's bankruptcy estate for the benefit of Coleman's creditors.[13] Among such creditors were 400 Coleman employees who claimed interests in the corporation's ERISA-qualified pension plan.[14] Eventually, all the employees were fully paid their respective interests in the plan, with the exception of Joseph B. Shumate, Jr., Coleman's president and chairman of the board of directors.[15]

Due to financial difficulties of his own, Shumate also filed a chapter 11 bankruptcy in Virginia two years after Coleman filed. Shumate's case was later converted to a chapter 7 proceeding as well.[16] The trustee named for Shumate's bankruptcy, John Patterson, initiated an adversary proceeding in bankruptcy court against Coleman's trustee, Creasy, in order to collect Shumate's $250,000 interest in the pension plan so as to distribute the value among Shumate's creditors.[17] During the pendency of the adversary suit, however, Shumate petitioned the district court to compel Creasy to pay Shumate's interest in the plan, directly to Shumate, rather than distributing it to Patterson.[18] Since the court was handling a related proceeding, it assumed jurisdiction and consolidated Patterson and Shumate's claims against Creasy. The district court ruled that applicable nonbankruptcy law was solely comprised of state spendthrift trust law and, as such, Shumate's interest in the plan was includible as part of his bankruptcy estate because Shumate retained too much control over the operation and termination of the

12. *Id.* at 2245.
13. *Id.*
14. The Coleman plan met all the requirements for an ERISA-qualified plan including, most importantly for purposes of this article, the anti-alienation provision providing that pension benefits are not assignable or transferable. *See supra* note 3 (listing the requirements). Specifically, article 16.1 of the Coleman plan stated: "'No benefit, right or interest' of any participant 'shall be subject to alienation, sale, transfer, assignment, pledge, encumbrance or charge, seizure, attachment or other legal, equitable or other process.'" *Patterson*, 112 S. Ct. at 2247.
15. *Id.* at 2245.
16. *Id.*
17. *Id.*
18. *Id.*

pension plan, in contravention to Virginia trust law.[19] Consequently, Shumate appealed the lower court decision to the Court of Appeals for the Fourth Circuit, which reversed the district court's holding, adjudging that applicable nonbankruptcy law incorporates any state or federal law.[20] The appellate court, therefore, applied ERISA as the governing law and found that, in accord with ERISA's mandates and pursuant to the dictates of section 541(c)(2), Shumate's pension interests were sufficiently restricted from transfer to render them excluded from his bankruptcy estate.[21]

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19. A spendthrift trust is a trust in which a beneficiary's right to future payments cannot be voluntarily transferred by him or involuntarily transferred by way of his creditors reaching such payments. *See In re* Graham, 726 F.2d 1268, 1271 (8th Cir. 1984). Therefore, the district court adopted a control test, whereby, the inquiry focused on the degree of control exercised by Shumate over the Coleman plan. Creasy v. Coleman, 83 B.R. 404, 407 (Bankr. W.D. Va. 1988). The court found that Shumate had exerted "great control" over the Coleman plan because he had voting control of the stock and, thus, could have voted to terminate the plan at any time. Additionally, he had the option of receiving a lump sum payment upon termination of the plan and he retained the ability to pay himself the "reversion of any overfunded amount as a dividend on his stock." *Id.* at 408. As a consequence, the court invalidated the "trust" (or pension plan), explaining that it was not a true spendthrift trust in that it allowed for too much control by the beneficiary. *Id.* at 410. Thus, Shumate's pension interests could not be excluded from his estate, since there were not sufficient restrictions on the transfer of Shumate's pension benefits pursuant to § 541(c)(2). *Id.*

Prior to the *Patterson* decision, the majority view was that § 541(c)(2) only encompassed state spendthrift trust law and, thus, only a valid trust, providing little or no control over its administration by a beneficiary-debtor, could qualify for exclusion from that debtor's estate. *See* Humphrey v. Buckley (*In re* Swanson), 873 F.2d 1121, 1123 (8th Cir. 1989); Daniel v. Security Pac. Nat'l Bank (*In re* Daniel), 771 F.2d 1352 (9th Cir. 1985), *cert. denied*, 475 U.S. 1016 (1986); Lichstrahl v. Bankers Trust (*In re* Lichstrahl), 750 F.2d 1488, 1490 (11th Cir. 1985); Samore v. Graham (*In re* Graham), 726 F.2d 1268, 1271 (8th Cir. 1984); Goff v. Taylor (*In re* Goff), 706 F.2d 574, 580 (5th Cir. 1983); *In re* Burns, 108 B.R. 308, 312 (1989); *In re* Alagna, 107 B.R. 301 (Bankr. D. Colo. 1989); *In re* Weeks, 106 B.R. 257 (Bankr. E.D. Okla. 1989); Fogler v. Flindall (*In re* Flindall), 105 B.R. 32, 40 (Bankr. D. Ariz. 1989); *In re* Herndon, 102 B.R. 893, 896 (Bankr. M.D. Ga. 1989); *In re* Griggs, 101 B.R. 393, 395 (Bankr. M.D. Ga. 1989); Blackwell v. Wallace (*In re* Wallace), 66 B.R. 834, 840 (Bankr. E.D. Mo. 1986); *In re* Matteson, 58 B.R. 909, 911 (Bankr. D. Colo. 1986).

Once the *Patterson* Court found that § 541(c)(2) also incorporated federal law, including ERISA, the inquiry as to a beneficiary's control over the administration of the pension plan was no longer central, as long as the ERISA plan contained an anti-alienation clause, so as to satisfy the requirements of § 541(c)(2) for a restriction on the transfer of the debtor's pension benefits.

20. Shumate v. Patterson, 943 F.2d 362, 365-66 (4th Cir. 1991).

21. *Id.* at 365. Prior to *Patterson*, the minority view was that federal law was included within the scope of § 541(c)(2) and, thus, ERISA could be applied to the exclusion of estate property analysis. *See In re* Idalski, 123 B.R. 222 (Bankr. E.D. Mich. 1991); Forbes v.

Patterson appealed the court of appeals holding and the United States Supreme Court granted certiorari, affirming the Fourth Circuit's decision for the reasons stated below.[22]

C. *The Court's Analysis*

1. Applicable Nonbankruptcy Law

The *Patterson* Court determined that "applicable nonbankruptcy law" referred to both state law and any federal law, such as ERISA.[23] The Court reached this conclusion by examining the plain language of section 541(c)(2), noting that the text does not limit the source of law categorized as "applicable nonbankruptcy law"[24] and, thus, the petitioner had an "'exceptionally heavy'" burden of persuading the Court otherwise.[25] In light of the clear statutory language, the Court found improper, previous reliance by courts of appeals on "isolated excerpts" of legislative history suggesting that only state law was implicated by section 541(c)(2).[26]

Aside from the fact that use of legislative history was inappropriate, the Court observed that the legislative history cited was inconclusive, whereas, House and Senate reports mentioning spendthrift trusts in connection with section 541(c)(2) only indicated to the Court that Congress intended to include state spendthrift trust law as a component of what constitutes applicable nonbankruptcy law, not that such reports indicated congressional intent to exclude other state law or any federal law from section 541(c)(2) coverage.[27] The Court reasoned that Congress had to have intended that

Lucas (*In re* Lucas), 924 F.2d 597 (6th Cir. 1991); Anderson v. Raine (*In re* Moore), 907 F.2d 1476 (4th Cir. 1990); *In re* Cheaver, 121 B.R. 665 (Bankr. D. D.C. 1990); *In re* Majul, 119 B.R. 118 (Bankr. W.D. Tex. 1990); *In re* Ralstin, 61 B.R. 502, 504-05 (Bankr. D. Kan. 1986); *In re* Mosley, 42 B.R. 181 (Bankr. D. N.J. 1984); Warren v. G.M. Scott & Sons, 34 B.R. 543, 544 (Bankr. S.D. Ohio 1983); *In re* Rogers, 24 B.R. 181, 183 (Bankr. D. Ariz. 1982); Clotfelter v. CIBA-GEIGY (*In re* Threewitt), 24 B.R. 927-29 (Bankr. D. Kan. 1982).

22. *Patterson*, 112 S. Ct. at 2245.

23. *Id.* at 2249-50. Justice Blackmun delivered the opinion of the Court and Justice Scalia filed a concurring opinion.

24. *Id.*

25. *Id.* at 2247 (citing Union Bank v. Wolas, 112 S. Ct. 527 (1991)).

26. *Id.* at 2248 n.4. To support this argument, the *Patterson* Court cited to Toibb v. Radloff for the proposition that resort to a statute's legislative history is improper when there are no ambiguities contained within the statutory language. 111 S. Ct. 2197, 2200 (1991).

27. *Patterson*, 112 S. Ct. at 2248; *see, e.g.*, *In re* Graham, 726 F.2d 1268, 1271-72 (8th Cir, 1984) (citing to House and Senate reports which only *mention* state trust law in connection with § 541(c)(2), rather than *restrict* the section to that source of law).

more than state law be implicated by section 541(c)(2), since Congress has previously made clear in several other sections of the Code exactly when state law is the only source of law to be considered.[28]

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28. *Patterson*, 112 S. Ct. at 2246. The Court stated that the following six Code §§ are expressly governed by the dictates of state law. First, § 109(c)(2) of the Bankruptcy Code states in pertinent part:

> (c) An entity may be a debtor under chapter 9 of this title if and only if such entity—
>
> . . . .
>
> (2) is generally authorized to be a debtor under chapter by State law, or by a governmental officer or organization empowered by State law to authorize such entity to be a debtor under chapter;

11 U.S.C. § 109(c)(2).

Second, § 362(b)(12) of the Code states:

> (b) The filing of a petition under section 301, 302, or 303 of this title, or of an application under section 5(a)(3) of the Securities Investor Protection Act of 1970 (15 U.S.C. 78eee(a)(3)), does not operate as a stay—
>
> . . . .
>
> (12) under subsection (a) of this section, after the date which is 90 days after the filing of such petition, of the commencement or continuation, and conclusion to the entry of final judgment, of an action which involves a debtor subject to reorganization pursuant to chapter 11 of this title and which was brought by the Secretary of Transportation under the Ship Mortage Act, 1920 (46 App. U.S.C. 911 *et seq.*) (including distribution of any proceeds of sale) to foreclose a preferred ship or fleet mortgage, or a security interest in or relating to a vessel or vessel under construction, held by the Secretary of Transportation under section 207 or title XI of the Merchant Marine Act, 1936 (46 App. U.S.C. 1117 and 1271 *et seq.*, respectively), or under applicable State law;

Id. § 362(b)(12).

Third, § 522(b)(1) of the Code provides:

> (b) Notwithstanding section 541 of this title, an individual debtor may exempt from property of the estate the property listed in either paragraph (1) or, in the alternative, paragraph (2) of this subsection. . . . If the parties cannot agree on the alternative to be elected, they shall be deemed to elect paragraph (1), where such election is permitted under the law of the jurisdiction where the case is filed. Such property is—
>
> (1) property that is specified under subsection (d) of this section, unless the State law that is applicable to the debtor under paragraph (2)(A) of this subsection specifically does not so authorize; or, in the alternative,

Id. § 522(b)(1).

Fourth, § 523(a)(5) states in pertinent part:

> (a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt—
>
> . . . .
>
> (5) to a spouse, former spouse, or child of the debtor, for the alimony to, maintenance for, or support of such spouse or child, in connection with a

The Court also noted that the phrase, "applicable nonbankruptcy law," as it appears in other sections of the Code, has been interpreted by numerous courts to include federal law.[29] Given a cardinal rule of statutory construction, that words are presumed to have the same meaning in all subsections of the same statute, the Court concluded that they should attach the same construction to section 541(c)(2) as is accorded other Code provisions mirroring the same language.[30]

2. Enforceable Restriction on Transfer

Once the Court found that any relevant nonbankruptcy law, state or federal, was encompassed by section 541(c)(2), it chose to apply ERISA, federal law governing pension plans. The Court had to then decide whether ERISA's requirements for a qualified plan fulfilled the criteria of section 541(c)(2), namely, whether the Coleman plan, as governed by ERISA, contained the enforceable restriction on transfer of the debtor's beneficial interest[31] that is required by section 541(c)(2) in order to allow for the

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> separation agreement, divorce decree or other order of a court of record, determination made in accordance with state or territorial law by a governmental unit, or property settlement agreement, but not to the extent that—

Id. § 523(a)(5).

Fifth, § 903(1) states:

> This chapter does not limit or impair the power of a State to control, by legislation or otherwise, a municipality of or in such State in the exercise of the political or governmental powers of such municipality, including expenditures for such exercise, but—
>
> (1) a State law prescribing a method of compensation of indebtedness of such municipality may not bind any creditor that does not consent to such composition; and

Id. § 903(1).

Finally, the Code states in § 1145(a) that:

> (a) Except with respect to an entity that is an underwriter as defined in subsection (b) of this section, section 5 of the Securities Act of 1933 (15 U.S.C. 77e) and any State or local law requiring registration for offer or sale of a security or registration or licensing of an issuer of, underwriter of, or broker or dealer in, a security dose not apply to—

11 U.S.C. § 1145(a).

29. *Patterson*, 112 S. Ct. at 2246 n.2 (citing Code sections and case-law interpreting such sections to include federal law).

30. *Id.* (citing as support, for the rule of statutory construction, Morrison-Knudsen Constr. Co. v. Director, OWCP, 461 U.S. 624, 633 (1983)).

31. The Court never analyzed what comprises a debtor's "beneficial interest," most probably because it seemed obvious to the Court that pension benefits would constitute same. Despite the evident significance of the phrase, a beneficial interest is defined as a "[p]rofit,

exclusion of Shumate's pension interests from his bankruptcy estate.[32]

In order for a pension plan to be ERISA-qualified, ERISA mandates that the plan provide that benefits are neither assignable nor alienable.[33] Although not expressly defined in ERISA, the mandatory anti-alienation and anti-assignment clauses signify that plan benefits cannot be "anticipated, assigned (either at law or in equity), alienated or subject to attachment, garnishment, levy, execution or other legal or equitable process.[34] The Court found that the language in article 16.1 of the Coleman pension plan, in fact, specifically adhered to ERISA requirements by providing that plan benefits, rights and interests were not subject to "alienation, sale, transfer, assignment, pledge, encumbrance . . . or charge . . . ."[35] The Court also found that the Coleman plan restrictions were *enforceable* under ERISA, as additionally required by section 541(c)(2), since ERISA compels the trustee or fiduciary of the pension plan to act in accordance with the plan's directives.[36] Additionally, the standard set forth in ERISA by which to judge the appropriateness of a plan fiduciary's conduct in administering the plan, requires "the care, skill prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims."[37] In accord with this standard, a plan fiduciary can be liable in his representative capacity and individually as well for breaches of his fiduciary duties.[38] Furthermore, ERISA authorizes any party affiliated with the plan, including a participant, beneficiary, fiduciary or even the Secretary of Labor, to initiate legal proceedings for the purpose of enjoining acts or practices which violate ERISA or the plan's distinct terms.[39]

After coming full circle in its determination that the Coleman plan fulfilled the tenets of section 541(c)(2) by way of ERISA, the Court disposed of two additional arguments asserted by petitioner Patterson. To

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benefit, or advantage resulting from a contract, or the ownership of an estate as distinct from the legal ownership or control." BLACK'S LAW DICTIONARY 142 (5th ed. 1979).

32. *Patterson*, 112 S. Ct. at 2244-45.

33. *See* 29 U.S.C. § 1056(d)(1); 26 U.S.C. § 401(a)(13). As to additional prerequisites for an ERISA-qualified pension plan, see *supra* note 3.

34. Treas. Reg. § 1.401(a)-13(b)(1) (1989). Note that not all plans governed by ERISA require anti-alienation provisions. For more information on these types of plans, see part III of this article.

35. *Patterson*, 112 S. Ct. at 2247.

36. *Id.* (citing 29 U.S.C. § 1104(a)(1)(D) (1985)).

37. 29 U.S.C. § 1104(a)(1)(B) (1985).

38. *Id.* § 1109(a).

39. *Patterson*, 112 S. Ct. at 2247 (citing 29 U.S.C. §§ 1132(a)(3), (5) (1985)).

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begin with, Patterson argued that if section 541(c)(2) could work to exclude an ERISA-qualified pension plan from the bankruptcy estate, then section 522(d)(10)(E), which exempts similar interests, is rendered "superfluous."[40] The Court pointed out, however, that section 522(d)(10)(E) exempts a significantly broader variety of interests, not necessarily governed by transfer restrictions, and only to the extent necessary for the debtor's or his dependents' maintenance.[41] Thus, the Court responded that section 522(d)(10)(E) is not rendered superfluous because if a given property interest lacks enforceable transfer restrictions in accord with section 541(c)(2), then although the interest will be included in the bankruptcy estate, it may still be rendered exempt via section 522(d)(10)(E).[42]

Patterson also contended that by holding Shumate's interest in the Coleman pension plan as excludible from his bankruptcy estate by virtue of the restriction on transfer enforceable under the applicable nonbankruptcy law of ERISA, the Court frustrates the Code's policy underlying section 541(a)(1), namely, that a broad range of property interests must comprise the bankruptcy estate.[43]

Aside from the fact that section 541 allows for narrow exceptions to the inclusion of various property interests as part of the bankruptcy estate,[44] the

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40. *Id.*; 11 U.S.C. § 522(d)(10)(E) provides:

> (d) The following property may be exempted under subsection (b)(1) of this section:
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> . . . .
>
> (10) The debtor's right to receive—
>
> . . . .
>
> (E) a payment under a stock bonus, pension, profitsharing, annuity, or similar plan or contract on account of illness, disability, death, age or length of service, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor, unless—
>
> (i) such plan or contract was established by or under the auspices of an insider that employed the debtor at the time the debtor's rights under such plan or contract arose;
>
> (ii) such payment is on account of age or length of service; and
>
> (iii) such plan or contract does not qualify under section 401(a), 403(a), 403(b), 408, or 409 of the Internal Revenue Code of 1954 (26 U.S.C. 401(a), 403(a), 403(b), 408, or 409).

11 U.S.C. § 522(d)(10)(E).

41. *Patterson*, 112 S. Ct. at 2248-49.

42. *Id.* As to the possibility of exempting other plan interests governed by ERISA which are included in the debtor's estate since they lack restrictions on transfer, see part III of this article.

43. *Id.* at 2249; *see supra* note 7 and accompanying text.

44. *See* 11 U.S.C. § 541(b)(1)-(3), (c)(2), (d) (1988).

Court defended its holding as a means for facilitating ERISA's goal of protecting income for pensioners and other potential beneficiaries, such as the debtor's dependents.[45] ERISA's objective of protecting a pensioner's benefits for use by the beneficiary or his family upon the pensioner's retirement is so steadfast, noted the Court, that it even refused to impose a constructive trust on the pension benefits of a union official who had pleaded guilty to embezzling over $377,000 in labor union funds.[46]

In *Guidry v. Sheet Metal Workers National Pension Fund*, the Court held that the constructive trust remedy sought by the labor union violated ERISA's prohibition against assignment or alienation of pension benefits and, thus, Guidry was allowed to recover his retirement benefits.[47] To justify its strict adherence to protecting benefits even where the equities seemed to indicate otherwise, the *Patterson* Court reiterated its rationale in *Guidry*:

> Section [1056(d)] reflects a considered congressional policy choice, a decision to safeguard a stream of income for pensioners (and their dependents, who may be, and perhaps usually are, blameless), even if that decision prevents others from securing relief for the wrongs done them. If exceptions to this policy are to be made, it is for Congress to undertake that task.[48]

The *Patterson* Court also declared that its holding ensured that pension benefits will receive consistent treatment and effect under ERISA, irrespective of whether the beneficiary has filed for bankruptcy or not.[49] In this respect, a creditor would similarly be incapable of reaching pension interests directly via garnishment proceedings or indirectly, by way of filing an

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45. *Patterson*, 112 S. Ct. at 2250. Indeed, Congress found that:

> [T]he growth in size, scope, and numbers of employee benefit plans in recent years has been rapid and substantial . . . that the continued well-being and security of millions of employees and their dependents are directly affected by these plans; that they are affected with a national public interest . . . [and that] employees and their beneficiaries have been deprived of anticipated benefits . . . [and, thus,] [i]t is . . . the policy of [ERISA] to protect . . . the interests of participants in employee benefit plans and their beneficiaries [as well] . . . .

29 U.S.C. § 1001(a), (b).

46. Guidry v. Sheet Metal Workers Nat'l Pension Fund, 493 U.S. 365, 373-74 (1990).

47. *Id.* at 375-76.

48. *Patterson*, 112 S. Ct. at 2250 (citing *Guidry*, 493 U.S. at 376).

49. *Id.* at 2249-50.

involuntary bankruptcy petition against the beneficiary.[50]

Finally, by holding that applicable nonbankruptcy law includes federal law, such as ERISA, the *Patterson* Court stated that it was promoting yet another vital policy underlying ERISA by creating "uniform national treatment of pension benefits . . . [rather than subjecting a debtor's pension benefits] to the vagrancies of state spendthrift trust law."[51]

III. Exempting Other ERISA Plan Interests From the Bankruptcy Estate

Since the Court determined that Shumate's ERISA-qualified pension benefits were excluded from his estate under section 541(c)(2), it was unnecessary for the Court to further analyze whether his pension benefits were also exempt.[52]

However, the issue of exempting benefits is important regarding ERISA plans that are not restricted by anti-alienation and anti-assignment clauses. Because such plans are unable to satisfy the section 541(c)(2) requirement that there be a restriction on transfer of the debtor's interest, benefits accruing to the debtor are included as property of the estate. The debtor's last resort then, is to try and exempt his interests under the plan from his estate.

For instance, under ERISA, welfare benefit plans are not subject to a prohibition on transfer standard.[53] The *Patterson* Court also noted that

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50. *Id.* at 2250. (For this proposition, the Court cited Donna Litman Seiden, *Chapter 7 Cases: Do ERISA and the Bankruptcy Code Conflict as to Whether a Debtor's Interest in or Rights Under a Qualified Plan Can be Used to Pay Claims?*, 61 AM. BANKR. L.J. 301, 317 (Fall 1987).

51. *Id.*; *see infra* notes 62, 64 and accompanying text.

52. *See supra* note 5.

53. Miami Children's Hosp., Inc. v. Malakoff, 765 F. Supp. 718, 720 (1991) (ruling that anti-alienation provisions do not apply to health care benefits of ERISA-governed medical plans); Wisconsin Dep't of Health & Social Serv. v. Upholsterers Int'l Union Health & Welfare Fund, 686 F. Supp. 708, 713-14 (1988) (finding that the prohibition against assignment of benefits does not apply to medical and disability benefits); Arizona Laborers, Teamsters, & Cement Masons, Local 395 Pension Trust Fund v. Nevarez, 661 F. Supp. 365, 369 (1987).

ERISA defines a welfare plan as:

> Any plan, fund, or program which was heretofore or is hereafter established or maintained by an employer or by an employee organization, or by both, to the extent that such plan, fund, or program was established or is maintained for the purpose of providing for its participants or their beneficiaries, through the

ERISA pension plans established by churches or governmental entities, as well as individual retirement accounts, need not comply with the anti-alienation provision of section 1056(d)(1).[54]

Yet, the debtor's success in arguing for an exemption may be limited, depending on the exemption schemes available to him in his state of residence.[55] The Code allows states to "opt-out" of the Code's list of exemptions and, in fact, most states have.[56] If the debtor's state has not opted out, he can either utilize his own state's exemptions, along with any federal nonbankruptcy ones available, or he can elect to only use the Code's exemptions, specifically, section 522(d)(10)(E), as regards pension plans and comparable interests.[57] However, if the debtor's state has opted out of the

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> purchase of insurance or otherwise, (A) medical, surgical, or hospital care or benefits, or benefits in the event of sickness, accident, disability, death or unemployment, or vacation benefits, apprenticeship or other training programs, or day care centers, scholarship funds, or prepaid legal services, or (B) any benefit described in section 186(c) of this title (other than pensions on retirement or death, and insurance to provide such pensions).

29 U.S.C. § 1002(1) (1988). Recall that ERISA governs both pension and welfare plans. *See supra* note 3 for ERISA's definition of pension plans.

54. *Patterson*, 112 S. Ct. at 2249 (citing 29 U.S.C. § 1003(b)(1)-(2); 29 U.S.C. § 1051(6)). For more detailed discussions as to the multitude of complex plan arrangements governed by ERISA, see Donna Litman Seiden, *Chapter 7 Cases: Do ERISA and the Bankruptcy Code Conflict as to Whether a Debtor's Interest in or Rights Under a Qualified Plan Can be Used to Pay Claims?*, 661 AM. BANKR. L.J. 219 (Summer 1987).

55. A debtor's domiciliary state is one which he has resided in for a minimum of 180 days before filing for bankruptcy or where he has lived for the longest time within the 180 day period. 11 U.S.C. § 522(b)(2)(A) (1988).

56. *Id.* § 522(b)(1). A majority of states, including Florida, have opted out of the Code's exemption scheme. For a listing of such states, see Seiden, *supra* note 50, at n.157.

57. *Id.* § 522(b). However, if the debtor's interest in a particular plan does not coincide with the types of plans that are exempt under § 522(d)(10)(E), then the debtor cannot utilize the Code's exemptions (full text of § 522(d)(10)(E) appears in note 40). The bankruptcy court in *In re Pauquette* provided insight as to what interests are incorporated within this section:

> The legislative history of section 522(d)(10)(E) speaks to "benefits akin to future earnings of the debtor." House Report No. 95-595, 95th Cong., 1st Sess. 362 (1977), U.S. Code Cong. & Admin. News 1978, 5787, 6318. The intent is to ensure that such benefits are available for retirement purposes. The test which has developed to determine whether a contract provides benefits akin to future earnings is whether account funds may be used only for the purpose of providing retirement benefits to the contract holder or to his beneficiaries in the event of his death. The test is satisfied where account funds can be diverted to no other purpose than the retirement income of the contract holder: where access to the account funds can be achieved only upon the contract holder's

Code's exemptions, then section 522(b)(2)(A) only allows the debtor to use his federal nonbankruptcy exemptions, as well as any relevant ones enacted by his state of residence.[58]

In light of the view advanced by the majority of courts that have dealt with this issue, a debtor residing in a state which has opted out of the Code, may be precluded from exempting his ERISA plan benefits altogether, under either of section 522(b)(2)(A)'s provisions for federal law or state law exemptions. To begin with, various circuit courts of appeals have ruled that ERISA does not constitute federal nonbankruptcy law under section 522(b)(2)(A) since: 1) ERISA was not among the federal statutes mentioned in the "illustrative list" in House and Senate reports addressing the scope of this section;[59] 2) ERISA does not resemble the enumerated federal statutes,

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> disability, death or retirement; where future payments, distributions, or return of capital may not occur except as an incident of disability, death, termination of employment, or retirement. Alternatively, where account funds may be withdrawn at any time by the contract holder, even if any early withdrawal assessment is an incident of the early withdrawal, the courts have unanimously rejected a claim of exemption under § 522(d)(10)(E).

115 B.R. 974, 979 (Bankr. W.D. Wis. 1990).

58. 11 U.S.C. § 522(b)(2)(A). This section provides, in pertinent part that:

> (b) an individual debtor may exempt from property of the estate . . . .
> . . . .
> (2)(A) Any property that is exempt under *Federal law*, other than subsection (d) of this section, or *State or local law* that is applicable on the date of filing of the petition at the place in which the debtor's domicile has been located for the 180 days immediately preceding the date of filing of the petition, or for a longer portion of such 180-day period than in any place.

Id. (emphasis added).

59. Daniel v. Security Pac. Nat'l Bank (*In re* Daniel), 771 F.2d 1352, 1360-61 (9th Cir. 1985); Lichstrahl v. Bankers Trust (*In re* Lichstrahl), 750 F.2d 1488, 1491 (11th Cir. 1985); Samore v. Graham (*In re* Graham), 726 F.2d 1268, 1273-74 (8th Cir. 1984); Goff v. Taylor (*In re* Goff), 706 F.2d 574, 585 (5th Cir. 1983). It is important to note, however, that the aforementioned courts refer to the list as "illustrative," and, thus, not necessarily exhaustive of all federal law implicated by § 522(b)(2)(A). *In re Daniel*, 771 F.2d at 1360; *In re Lichstrahl*, 750 F.2d at 1491; *In re Graham*, 726 F.2d at 1274; *In re* Goff, 706 F.2d at 585.

The federal nonbankruptcy exemptions included on the legislature's list are: Foreign Service Retirement and Disability payments, 22 U.S.C. § 1104; Social security payments, 42 U.S.C. § 407; Injury or death compensation payments from war risk hazards, 42 U.S.C. § 1717; Wages of fishermen, seamen, and apprentices, 46 U.S.C. § 601; Civil service retirement benefits, 5 U.S.C. §§ 729, 2265; Longshoremen's and Harbor Workers' Compensation Act death and disability benefits, 33 U.S.C. § 916; Railroad Retirement Act annuities and pensions, 45 U.S.C. § 228(L); Veterans benefits, 45 U.S.C. § 352(E); Special pensions paid to winners of the Congressional Medal of Honor, 38 U.S.C. § 3101; and Federal homestead lands on debts contracted before issuance of the patent, 43 U.S.C. § 175.

which are all "peculiarly federal [or public] in nature, created by federal law or related to industries protected by the federal government," as opposed to ERISA, which is federal law regulating "private employer pension systems";[60] and 3) Congress did not refer to ERISA in the text of section 522(b)(2)(A) and, thus, left it out intentionally since Congress did allude to ERISA in section 522(d)(10)(E).[61]

Most courts have also cited to provisions within ERISA, case law and legislative history as a basis for holding that state created exemptions addressing employee benefit plans are preempted by ERISA, regardless of whether the state exemption actually refers to ERISA or not and despite the fact that the state exemption is consistent or even furthers ERISA's intended purposes.[62]

See In re Lichstrahl, 750 F.2d at 1491 (citing S. REP. NO. 989, 95th Cong., 2d Sess. 75 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5861; H.R. REP. NO. 595, 95th Cong., 2d Sess. 360 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6316).

60. *In re Daniel*, 771 F.2d at 1361; *In re Lichstrahl*, 750 F.2d at 1491; *In re Graham*, 726 F.2d at 1274; *In re Goff*, 706 F.2d at 585-86.

61. *In re Lichstrahl*, 750 F.2d at 1491. Although the Code does not expressly refer to ERISA in § 522(d)(10)(E)(iii), it does so implicitly by stating that a debtor will not receive an exemption for his interests in a plan that does not qualify under § 401(a) of the Internal Revenue Code, which is the section deeming an ERISA pension plan that has met all prerequisites "qualified" and, thus, entitled to favorable tax treatment an to exemption under § 522(d)(10)(E). *See supra* note 40.

62. ERISA expressly preempts "any and all State laws insofar as they may now or hereafter *relate to* any employee benefit plan" covered by ERISA. 29 U.S.C. § 1144(a) (emphasis added).

The United States Supreme Court has interpreted the language, "relate to," as signifying that ERISA preempts any state law "if [such state law] has a connection with or reference to . . . ." an ERISA plan. Mackey v. Lanier Collection Agency & Serv., Inc., 486 U.S. 825, 829 (1988). Other courts holding that ERISA preempts state law exemptions include: *In re* Fullmer, 127 B.R. 55, 59 (Bankr. D. Utah 1991); *In re* Gaines, 121 B.R. 1015, 1021-23 (Bankr. W.D. Mo. 1990); *In re* Wimmer, 121 B.R. 539, 543 (Bankr. C.D. Ill. 1990), *aff'd*, No. 91-1021 (C.D. Ill. July 19, 1991); *In re* Majul, 119 B.R. 118, 119 (Bankr. W.D. Tex. 1990); *In re* Starkey, 116 B.R. 259, 263-64 (Bankr. D. Colo. 1990); *In re* Martin, 115 B.R. 311, 322 (Bankr. D. Utah 1990); *In re* Schlein, 114 B.R. 780, 783 (Bankr. M.D. Fla. 1990); *In re* Conroy, 110 B.R. 492, 496 (Bankr. D. Mont. 1990); *In re* Burns, 108 B.R. 308, 311 (Bankr. W.D. Okla. 1989); *In re* Flindall, 105 B.R. 32, 37-38 (Bankr. D. Ariz. 1989); *In re* Siegel, 105 B.R. 556, 564 (Bankr. D. Ariz. 1989); *In re* Bryant, 106 B.R. 727, 730 (Bankr. M.D. Fla. 1989); *In re* Komet, 104 B.R. 799, 801-02 (Bankr. W.D. Tex. 1989); *In re* McLeod, 102 B.R. 60, 63 (Bankr. S.D. Miss. 1989); *In re* Dyke, 99 B.R. 343, 351-52 (Bankr. S.D. Tex. 1989).

Legislative history further reflects that ERISA may have been intended to govern over state law employee benefit exemptions: "[T]he crowning achievement of [ERISA is] the reservation to Federal authority to regulate the field of employee benefit plans. With the

There are courts comprising a strong minority, however, which have reached contrary interpretations, holding that a debtor residing in a state that has opted out of the Code can exempt benefits arising from a plan governed by ERISA via section 522(b)(2)(A), irrespective of whether the debtor seeks to exempt such benefits via federal nonbankruptcy exemptions or via his own state's exemption scheme. As regards the theory that federal non-bankruptcy exemptions within section 522(b)(2)(A) do not encompass ERISA, these courts have posited that the mere fact ERISA is not mentioned in the legislature's list of federal statutes is not enough to exclude ERISA from the provision's scope. These courts stress that since section 522(b)(2)-(A) explicitly refers to "federal law" without limiting the source of such law, the clear statutory language governs the provision's interpretation and, thus, references to legislative history are improper.[63]

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preemption of the field . . . protection [is] afforded participants by eliminating the threat of conflicting and inconsistent state and local regulation." 120 CONG. REC. H29,197 (1974).

Notwithstanding the broad holdings favoring preemption, a distinction was made by the *Mackey* Court and other lower courts that only pension plans, as opposed to welfare plans, covered by state law exemptions are preempted by ERISA. *Mackey*, 486 U.S. at 831-41 (finding that a state garnishment statute was not preempted by ERISA as to the interest held by a beneficiary of an ERISA welfare benefit plan and, thus, the beneficiary's interest could be reached by creditors via the state statute). The rationale behind this distinction is based on legislative history and ERISA provisions which reveal that Congress was much more concerned with a beneficiary's forfeiture of retirement benefits than with his potential loss of health-care and vacation welfare benefits and, thus, ERISA regulates pension plans much more extensively than it does welfare plans. Arizona Laborers, Teamsters & Cement Masons, Local 395 Pension Trust Fund v. Nevarez, 661 F. Supp. 365, 369 (Bankr. D. Ariz. 1987). For instance, welfare plans under ERISA are not subject to the anti-alienation requirements that pension plans mandate in order to ensure that creditors cannot reach the debtor- beneficiary's pension benefits. *See* 29 U.S.C. § 1056(d)(1). Thus, states arguably have more leeway to regulate the area of welfare plans since ERISA does not attempt to govern such plans exclusively.

63. For the pertinent text to this section, see *supra* note 58. Courts adhering to the aforementioned minority view include: *In re* Suarez, 127 B.R. 73,79 (Bankr. S.D. Fla. 1991); *In re* Burns, 108 B.R. 308 (Bankr. W.D. Okla. 1989); *In re* Komet, 104 B.R. 799, 805-16 (Bankr. W.D. Tex. 1989); *In re* Hinshaw, 23 B.R. 233 (Bankr. D. Kan. 1982). This argument is similar to the *Patterson* Court's analysis regarding the interpretation of § 541(c)(2)'s phrase "applicable nonbankruptcy law" to include all sources of law since the text does not limit same and, thus, the *Patterson* Court found inappropriate other courts' resort to legislative history. *See supra* note 26 and accompanying text.

For instance, the *Komet* court found that the *Goff*, *Graham*, *Daniel* and *Lichstrahl* courts inappropriately based their decision that § 522(b)(2)(A) does not encompass ERISA, in light of House and Senate reports failing to list ERISA, even though the section, on its face, refers to "federal law" exemptions in general terms. 104 B.R. at 814. The court explained that references to the section's legislative history, especially the type that provides

The minority view as to ERISA's preemptive effect on state exemption equivalents asserts that state laws which are consistent and, therefore, promote ERISA's objectives rather than conflict or deviate from them, are not preempted by ERISA.[64]

Given the foregoing, the fate of ERISA plan interests, other than qualified pension benefits, seem grim. A debtor whose domiciliary state has opted out of the Code's exemptions may find himself in a catch-22, whereas, he cannot exempt the benefits due him from an employee benefit plan because federal law under section 522(b)(2)(A) does not include ERISA and state law under this same Code section is preempted by ERISA.

IV. CONCLUSION

Patterson v. Shumate established that a debtor, holding an interest in ERISA-qualified pension benefits, will automatically be able to retain such benefits in favor of himself and his dependents. The law is not similarly settled as to other plan benefits governed by ERISA that do not require the anti-alienation and anti-assignment provisions which would otherwise have

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only an "illustrative list" of federal statutes included within the section's scope, is misplaced and inappropriate. *Id.*

As regards the specific use of illustrative lists by Congress, the *Komet* court stated:

> It is a nonsequitur to say that the failure to include something on an illustrative list is probative of an intent to exclude it from that list. Illustrative lists (in contrast to exhaustive lists) by their nature preclude the possibility of "overlooking" a statute of the type already listed . . . . The statute has long adopted an attitude of neutrality toward the nature and extent of a given exemption, leaving that issue to be controlled by the statute which confers the exemption and the case law which construes it. Against this backdrop, the legislative history cannot be read to be anything more than what it purports to be an "illustrative" list which merely indicates what might qualify for exemption under Section 522(b)(2)(A). It is up to the courts to determine whether a given statute confers an exemption, without resort to bankruptcy law, much less resort to its legislative history.

Id. at 815.

64. *In re* Shaker, 137 B.R. 930 (Bankr. W.D. Wis. 1992); *In re* Rosenbloom, 132 B.R. 970 (Bankr. S.D. Fla. 1991) (Weaver, J.); *In re* Kimmel, 131 B.R. 223 (Bankr. S.D. Fla. 1991) (Weaver, J.); *In re* Barlage, 121 B.R. 352 (Bankr. D. Minn. 1990); *In re* Volpe, 120 B.R. 843, 847 (Bankr. W.D. Tex. 1990); *In re* Dyke, 119 B.R. 536, 539 (Bankr. S.D. Tex. 1990); *In re* Williams, 118 B.R. 812 (Bankr. N.D. Fla. 1990); *In re* Vickers, 116 B.R. 149 (Bankr. W.D. Mo.), *aff'd*, 126 B.R. 348 (Bankr. W.D. Mo. 1990); *In re* Seilkop, 107 B.R. 776, 778 (Bankr. S.D. Fla. 1989) (Weaver, J.); *In re* Martinez, 107 B.R. 378 (Bankr. S.D. Fla. 1989) (Weaver, J.); *In re* Bryan, 106 B.R. 749, 751 (Bankr. S.D. Fla. 1989).

rendered such interests excludible from the debtor's estate under section 541(c)(1). Thus, courts will have to continue grappling with the aforementioned exemption and preemption arguments until the United States Supreme Court provides definitive guidance on these issues as well.